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# **China, Peoples Republic of**

## **Tobacco and Products**

### **Annual, Part 1**

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#### **Report Highlights:**

**Tobacco production increased by 3.4% in 2000 in response to improved tobacco prices and falling prices for other commodities. Trade has also increased as China imports more high quality tobacco and exports low quality tobacco. Although recent settlement of the tobacco blue mold issue and China's pending WTO accession promise greater access to the market, China's strict production quotas on cigarettes are likely to limit imports in the near term.**

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## Tobacco Situation and Outlook

The general condition of China's tobacco industry appears to have improved, with increased profitability for cigarette companies, despite some backsliding on production limits. Nonetheless, the industry's problems remain significant. Despite an aggressive crackdown, illegal cigarette production continues to be a major headache, undercutting legal sales and evading taxes. Smuggling also continues to be a problem, and recent statistics indicate that illegal imports may be on the rise.

Although the Chinese government continues to try to limit tobacco production, its efforts are being undermined by high support prices for tobacco and falling prices for other commodities. Procurement prices for tobacco rose by 3.4% in 2000. As a result, production rose to 2.16 MMT, and is forecast to remain relatively steady during 2001. This follows on a sharp drop in production in 1998, and likely indicates that production is finally coming into line with demand. This contention is further supported by the continued decline in stocks, which fell nearly 400 TMT in 2000, and are forecast to fall the same amount in 2001. Given the importance of tobacco as a cash crop, particularly in poor and minority areas, further cuts in planted area are unlikely. Current efforts are now focused on improving the quality of tobacco, as production of high-quality tobacco is currently short of demand.

Cigarette production is limited by strict production quotas, and total registered production increased by only 1.5% in 2000. Production of high quality cigarettes has increased more rapidly, though apparently not quickly enough to match the shift in demand. As a result, significant stocks of middle and lower quality cigarettes have begun to accumulate. The State Tobacco Monopoly Administration (STMA) is now pursuing plans to consolidate production by closing small and unprofitable manufacturers and redistributing their production quotas to larger companies.

Recent household surveys indicate that per capita tobacco consumption is falling, particularly in urban areas, where consumption is typically higher. Growing health concerns are cited as the main reason, along with a decline in the tradition of giving cigarettes as gifts and increased restrictions on smoking in public areas. The same health concerns that are causing consumption to fall are also causing a shift in demand toward higher-quality, low-tar cigarettes and blended cigarettes.

The domestic imbalance between the quality of tobacco produced and consumed has led to an increase in both imports and exports, as China brings in high quality tobacco, while exporting low quality. Chinese processors remain highly price sensitive, favoring inexpensive tobacco from Brazil and Zimbabwe. U.S. tobacco recently gained access to the Chinese market, and China's entry into the WTO should increase access even further. Demand for imports is likely to be limited, however, as cigarette production quotas limit the amount of tobacco demanded by the industry. Cigarette imports are also likely to increase, but face two significant hurdles. The first is the general preference for non-blended cigarettes. Though demand for blends is expected to rise, the market is likely to remain relatively small for some time to come. (A large proportion of imported cigarettes are blended, so demand for blends has a disproportionate impact on imports). Second, the quality of domestic cigarettes is rising quickly as Chinese companies upgrade their processing and a growing number of foreign joint ventures are producing cigarettes in China.

## Statistical Tables

**Table 1. Unmanufactured Tobacco: Production, Supply and Distribution**

PSD Table						
Country:	China, Peoples Republic of					
Commodity:	Tobacco, Unmfg.					
		1999		2000		2001
	Old	New	Old	New	Old	New
Market Year Begin		01/1999		01/2000		01/2001
Area Planted	1374000	1374000	1358000	1437200	1360000	1425794
Beginning Stocks	3874000	3754450	3149888	3340032	2504419	2941020
Farm Sales Weight Prod	2469990	2469300	2441227	2543173	2445000	2587685
Dry Weight Production	2074792	2098905	2050631	2161697	2055000	2199532
U.S. Leaf Imports	0	0	500	0	500	300
Other Foreign Imports	10481	10481	45000	37831	50000	39397
TOTAL Imports	10481	10481	45500	37831	50500	39697
TOTAL SUPPLY	5959273	5863836	5246019	5539560	4609919	5180249
Exports	113259	113259	96100	113594	110000	115080
Dom. Leaf Consumption	2685645	2400064	2600000	2447115	2600000	2484040
U.S. Leaf Dom. Consum.	0	0	500	0	500	300
Other Foreign Consump.	10481	10481	45000	37831	50000	39397
TOTAL Dom. Consumption	2696126	2410545	2645500	2484946	2650500	2523737
TOTAL Disappearance	2809385	2523804	2741600	2598540	2760500	2638817
Ending Stocks	3149888	3340032	2504419	2941020	1849419	2541432
TOTAL DISTRIBUTION	5959273	5863836	5246019	5539560	4609919	5180249

**Table 2. Flue-Cured Tobacco: Production, Supply and Distribution**

Production Table						
Country:						
Commodity:	Flue Cured					
		1999		2000		2001
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	1150000	1213388	1115000	1269200	0	1259127
Beginning Stocks	3535377	3535377	3051392	3058950	2613112	2600479
Farm Sales Weight Prod	2182000	2165221	2108000	2238000	0	2269643
Dry Weight Production	1832880	1840438	1770720	1902300	0	1929196
U.S. Leaf Imports	0	0	0	0	0	200
Other Foreign Imports	9565	9565	10200	36740	0	38377
TOTAL Imports	9565	9565	10200	36740	0	38577
TOTAL SUPPLY	5377822	5385380	4832312	4997990	2613112	4568252
Exports	108865	108865	109000	108611	0	110783
Dom. Leaf Consumption	2208000	2208000	2100000	2252160	0	2285942
U.S. Leaf Dom. Consum.	0	0	0	0	0	200
Other Foreign Consump.	9565	9565	10200	36740	0	38377
TOTAL Dom. Consumption	2217565	2217565	2110200	2288900	0	2324519
TOTAL Disappearance	2326430	2326430	2219200	2397511	0	2435302
Ending Stocks	3051392	3058950	2613112	2600479	0	2132950
TOTAL DISTRIBUTION	5377822	5385380	4832312	4997990	0	4568252

**Table 3. Burley Tobacco: Production, Supply and Distribution**

Production Table						
Country:						
Commodity:	Burley					
		1999		2000		2001
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	50000	126260	50000	132068		131020
Beginning Stocks	111643	111643	88549	178465	88549	247457
Farm Sales Weight Prod	120000	239042	120000	247077		250018
Dry Weight Production	100800	203186	100800	210015		212516
U.S. Leaf Imports	0	0	0	0		100
Other Foreign Imports	550	550	600	858		770
TOTAL Imports	550	550	600	858	0	870
TOTAL SUPPLY	212993	315379	189949	389338	88549	460843
Exports	1894	1894	1980	4536		3855
Dom. Leaf Consumption	122000	134470	128100	136487		138534
U.S. Leaf Dom. Consum.	0	0	0	0		100
Other Foreign Consump.	550	550	600	858		770
TOTAL Dom. Consumption	122550	135020	128700	137345	0	139404
TOTAL Disappearance	124444	136914	130680	141881	0	143259
Ending Stocks	88549	178465	59269	247457		317584
TOTAL DISTRIBUTION	212993	315379	189949	389338	0	460843

**Table 4. Oriental Tobacco: Production, Supply and Distribution**

Production Table						
Country:						
Commodity:	Oriental					
		1999		2000		2001
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	12000	10020	12000	10481	0	10397
Beginning Stocks	6600	6600	7920	6724	7740	555
Farm Sales Weight Prod	23000	18970	23000	10481	0	19841
Dry Weight Production	19320	16124	19320	8909	0	16865
U.S. Leaf Imports	0	0	0	0	0	0
Other Foreign Imports	366	366	400	68	0	82
TOTAL Imports	366	366	400	68	0	82
TOTAL SUPPLY	26286	23090	27640	15701	7740	17502
Exports	1500	1500	1500	360	0	367
Dom. Leaf Consumption	16500	14500	18000	14718	0	14938
U.S. Leaf Dom. Consum.	0	0	0	0	0	0
Other Foreign Consump.	366	366	400	68	0	82
TOTAL Dom. Consumption	16866	14866	18400	14786	0	15020
TOTAL Disappearance	18366	16366	19900	15146	0	15387
Ending Stocks	7920	6724	7740	555	0	2115
TOTAL DISTRIBUTION	26286	23090	27640	15701	0	17502

**Table 5. Dark Air and Sun Cured Tobacco: Production, Supply and Distr.**

Production Table						
Country:						
Commodity:	Dark Air & Sun Cured					
		1999		2000		2001
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	88000	24332	88000	25451	0	25250
Beginning Stocks	100830	100830	105030	95893	99230	92529
Farm Sales Weight Prod	155000	46067	155000	47616	0	48182
Dry Weight Production	130200	39157	130200	40473	0	40955
U.S. Leaf Imports	0	0	0	0	0	0
Other Foreign Imports	0	0	0	165	0	168
TOTAL Imports	0	0	0	165	0	168
TOTAL SUPPLY	231030	139987	235230	136531	99230	133652
Exports	1000	1000	1000	87	0	74
Dom. Leaf Consumption	125000	43094	135000	43750	0	44625
U.S. Leaf Dom. Consum.	0	0	0	0	0	0
Other Foreign Consump.	0	0	0	165	0	168
TOTAL Dom. Consumption	125000	43094	135000	43915	0	44793
TOTAL Disappearance	126000	44094	136000	44002	0	44867
Ending Stocks	105030	95893	99230	92529	0	88785
TOTAL DISTRIBUTION	231030	139987	235230	136531	0	133652



**Table 6. Cigarettes: Production, Supply and Distribution**

PSD Table						
Country:	China, Peoples Republic of					
Commodity:	Tobacco, Mfg., Cigarettes					
		1999		2000		2001
	Old	New	Old	New	Old	New
Market Year Begin		01/1999		01/2000		01/2001
Filter Production	1599850	1633260	1661000	1664530	1661100	1654670
Non-Filter Production	42650	36740	51500	33970	51550	30330
TOTAL Production	1642500	1670000	1712500	1698500	1712650	1685000
Imports	1805	3440	1751	2088	1800	2129
TOTAL SUPPLY	1644305	1673440	1714251	1700588	1714450	1687129
Exports	7437	7437	7157	12811	7250	13003
Domestic Consumption	1636868	1666003	1707094	1687777	1707200	1674126
TOTAL DISTRIBUTION	1644305	1673440	1714251	1700588	1714450	1687129

**Table 7. Tobacco Production by Province**

China's Leaf Tobacco Production Area By Province (1,000 HA)			
	1999	2000	2001
Province	Revised	Prelim	Forecast
Yunnan	328	340	355
Guizhou	224	214	210
Henan	139	166	158
Hunan	76	89	87
Sichuan	74	82	81
Hubei	74	75	89
Heilongjiang	64	49	48
Shandong	56	63	54
Chongqing	64	71	69
Shaanxi	50	52	47
Fujian	53	55	68
Others	171	182	158
TOTAL HA	1374	1437	1426
China's Leaf Tobacco Production Volume By Province (1,000 MT)			
	1999	2000	2001
Province	Revised	Prelim	Forecast
Yunnan	627	656	699
Guizhou	348	338	338
Henan	284	276	268
Hunan	136	168	168
Hubei	136	138	138
Sichuan	119	156	189
Shandong	114	117	117
Heilongjiang	112	96	84
Chongqing	96	104	104
Shaanxi	78	77	71
Fujian	88	94	117
Others	332	334	295
TOTAL MT	2469	2552	2588
All figures are Post estimates based on SSB, STMA and industry figures. 2001 Forecast is based on Chinese Academy of Agricultural Sciences estimates and may not match PSD figures.			

**Table 8. Tobacco Production by Type**

China's Tobacco Production By Tobacco Type (1999-2001)			
(Area in 1,000 HA)			
	Revised 1999	Prelim 2000	Forecast 2001
Flue Cured	1213	1269	1259
Burley	126	132	131
Oriental	10	10	10
Dark Air & Sun Cured	24	25	25
TOTAL	1374	1437	1426
Production in 1,000 MT Farm Sales Weight			
	Revised 1999	Prelim 2000	Forecast 2001
Flue Cured	2165	2238	2270
Burley	239	247	250
Oriental	19	20	20
Dark Air & Sun Cured	46	48	48
TOTAL	2469	2552	2588
All figures are post estimates based on SSB, STMA and industry figures. 2001 forecast is based on CAAS estimates and may not match PSD figures.			

**Table 9. Procurement Prices for Flue Cured Tobacco**

Procurement Prices for Flue Cured Tobacco (2000)							
US\$/MT							
	Region 1	Region 2	Region 3	Region 4	Region 5	% of 2000	% of 1999
						procurement	procurement
Class A	1654.55	1606.14	1473.64	1358.18	1277.95	25.50%	19%
C1F	2087.50	2025.00	1875.00	1725.00	1625.00		
C2F	1870.00	1817.50	1650.00	1520.00	1432.50		
C3F	1607.50	1562.50	1412.50	1300.00	1225.00		
C1L	1950.00	1892.50	1720.00	1587.50	1492.50		
C2L	1662.50	1612.50	1462.50	1350.00	1270.00		
B1F	1762.50	1712.50	1587.50	1462.50	1375.00		
B2F	1457.50	1412.50	1312.50	1212.50	1137.50		
B1L	1407.50	1370.00	1270.00	1170.00	1100.00		
B1R	1457.50	1412.50	1312.50	1212.50	1137.50		
H1F	1520.00	1475.00	1370.00	1262.50	1187.50		
X1F	1417.50	1375.00	1237.50	1137.50	1075.00		
Class B	1276.52	1255.57	1170.69	1077.86	1017.38		
C3L	1378.05	1329.27	1195.12	1097.56	1036.59		
X2F	1036.59	1000.00	926.83	853.66	804.88		
X3F	792.68	775.61	719.51	663.41	621.95		
X1L	1307.50	1267.50	1175.00	1082.50	1020.00		
X2L	1025.00	1000.00	925.00	850.00	800.00		
B3F	1032.50	987.50	925.00	850.00	812.50		
B4F	725.00	700.00	650.00	600.00	562.50		
B2L	1032.50	975.00	925.00	850.00	812.50		
B3L	725.00	700.00	650.00	597.50	562.50		
B2R	1182.50	1150.00	1087.50	1000.00	945.00		
B3R	662.50	892.50	850.00	782.50	737.50		
H2F	1270.00	1237.50	1145.00	1055.00	995.00		
X2V	795.00	775.00	720.00	662.50	625.00		
C3V	1245.00	1212.50	1125.00	1037.50	975.00		
B2V	945.00	920.00	875.00	805.00	765.00		
B3V	720.00	700.00	675.00	625.00	587.50		
S1	720.00	700.00	650.00	600.00	562.50		

Class C	377.00	369.50	367.00	349.50	330.25	17.5% C&D combined	24% C&D combined
						combined	combined
B4L	387.50	375.00	375.00	362.50	350.00		
X3L	612.50	600.00	600.00	562.50	530.00		
X4L	312.50	312.50	300.00	287.50	275.00		
X4F	400.00	387.50	387.50	375.00	362.50		
S2	387.50	382.50	375.00	350.00	325.00		
CX1K	480.00	475.00	475.00	445.00	412.50		
CX2K	257.50	250.00	245.00	237.50	220.00		
B1K	457.50	450.00	450.00	432.50	407.50		
B2K	262.50	250.00	250.00	242.50	232.50		
GY1	212.50	212.50	212.50	200.00	187.50		
Class D	122.50	122.50	117.50	108.75	102.50		
B3K	150.00	150.00	145.00	132.50	125.00		
GY2	95.00	95.00	90.00	85.00	80.00		

**Table 10. Factory Price for Cigarettes**

Table 10. Factory Price for Cigarettes (2000)				
Class	Price in RMB/50,000pcs	Price in US\$/50,000pcs	Share of production (%)	Share of sales %
Class A	Greater than RMB 7,553	\$913.30	11.9	18.9
Class B	RMB 2,522 - 7,553	\$304.96 -913.30	20.2	21
Class C	RMB 1,220 - 2,522	\$147.52 -304.96	29.6	32.2
Class D&E	Less than RMB 1,220	Less than \$ 147.52	35.6 & 2.	25.0 & 2.9

**General Notes on Statistics**

NOTE 1: There are several sources of tobacco statistics for China, including the STMA, The National Statistical Bureau (NSB), the China Customs, and industry sources. This report considers all sources and uses the data that is considered to be the most appropriate. Trade data comes from Customs statistics. NSB is considered the most reliable source of tobacco production estimates, since STMA figures only account for tobacco procured.

NOTE 2: The unit amount used for the cigarette PS&D have been changed from 1,000 pieces to 1,000,000 pieces for ease of use and to bring the PS&D into compliance with FAS standards.

NOTE 3: The conversion factor from farm sales weight FSW to dry weight was changed in 1999 from 90 percent to 84 percent to reflect a more realistic loss factor for China.

NOTE 4: In China, one case (da xiang) of cigarettes equals 50,000 cigarettes. A box (jian) holds 10,000 cigarettes, or 50 cartons (tiao), which each hold 10 packs (bao) of 20 cigarettes.

## Production

### Tobacco

Tobacco planted area rose by 4.6% in 2000, despite government policies restricting the production of both tobacco and cigarettes. Area increased in all producing provinces except Heilongjiang, with the largest producer, Yunnan, posting a 3.4% increase over the previous year. Henan, Hunan, Sichuan, Shandong and Chongqing all saw double-digit increases in planted area. Total area is estimated at 1.437 million hectares. A summer drought in central and northern China caused yields to fall slightly, as a result of which production increased by only 3.4%. The National Statistical Bureau (NSB) estimates 2000 production at 2.552 MMT. Drought hit hardest in Henan and Shandong provinces, which recorded a drop in yields of 18.7% and 8.9%, respectively.

Most of China's tobacco is flue-cured tobacco, and is produced primarily in Yunnan, Guizhou and Henan, though small amounts are produced in nearly every province in the country. Burley tobacco is produced primarily in Hubei, Sichuan, Henan and Shanxi, while Yunnan, Xinjiang and Hubei are the main producers of oriental tobacco. For 2001, production is forecast to continue rising, as tobacco prices remain favorable compared to other crops. Increased production in Yunnan and Sichuan is likely to overwhelm production cuts in northern provinces such as Henan, Heilongjiang and Shaanxi. Production estimates for non flue-cured tobacco types have been revised once again, based on statistics newly available from State Tobacco Monopoly Administration (STMA). Continuous revisions of non-flue cured tobacco numbers are indicative of the general lack of reliable statistics. This is partly due to the fact that STMA's regulatory authority is limited to flue-cured tobacco.

Increased production for 2000 is linked to an average 3.4% increase in procurement prices for tobacco, and to falling prices for most other commodities. The average procurement price for tobacco in 2000 was \$777/MT, as compared to \$751/MT in 1999. Increases varied according to the class of tobacco: Class A increased from \$1,421/MT to \$1,474/MT; Class B from \$1,126/MT to \$1,160/MT; Class C from \$346/MT to \$359/MT and Class D from \$110/MT to \$115/MT.

Although production increased, the supply of high-quality tobacco has fallen behind demand. To promote increased production of high-quality tobacco, STMA has adopted two strategies. The first is to establish a technical support system providing extension services to pass along new planting technology. The second is to improve the types of tobacco being planted. In 2000, two national tobacco breeding facilities were established. One is located in the south, in Yuxi county, Yunnan province, and the other is in the north, in Qingzhou county of Shandong province. In addition to these, 26 high-quality tobacco breeding centers have been established in major production areas. As a result, the percentage of Class A tobacco has risen from 19% of total tobacco procured in 1999 to 25.5% in 2000. Class B production remained roughly constant at 57%, while Classes C and D fell from 24% to 17.5%. The STMA is also promoting increased production of oriental tobacco in Xinjiang as part of its efforts to reduce tar content through the production of blended cigarettes. Although production of blended cigarettes is growing, it remains low at roughly 5% of total cigarette production.

Illegal and unreported tobacco production continues to be a major headache for STMA, providing the materials needed to keep illegal cigarette factories in business. The total amount of unreported and illegal tobacco production is difficult to estimate for obvious reasons. However, the gap between STMA's total contracted production, and the National Statistical Bureau's survey results provide a clue. Total STMA contracted

production for 2000 was 1.663 MMT, while NSB estimates total production at 2.54 MMT. Part of this difference can be accounted for by production of non-flue cured tobacco, which is unregulated, and accounted for slightly over 305,000 MT according to STMA estimates. Most of the remaining production (roughly 570 TMT) is illegal, and is believed to go into illegal cigarette production.

### **Cigarettes and Cigars**

Cigarette production increased by 1.7% in 2000, to 1.7 trillion pieces. Filtered cigarettes continued to gain, accounting for the entire amount of the increase, and 98% of total production. Production of non-filtered cigarettes fell by 8%. By the same token, production of high-quality cigarettes continued to rise. Class A and B cigarettes now account for over 32% of production. Nonetheless, Class D continues to comprise the largest single category, at 35.6% of total production. The cigarette industry's financial situation has improved considerably over the past year, with the number of manufacturers running at a loss falling from 39 down to 12. Cigarette production is heavily regulated, based on quotas allocated to the factories by STMA.

China's cigarette industry continues to suffer from an excessive number of brands, and poor economies of scale. STMA estimates that there are 2,198 brands of cigarettes in China, with the average output of each brand reaching only 15,000 cases (at 50,000 pieces per case). Even among the top 69 manufacturers, the average output was only 100,000 cases. STMA now plans to consolidate the industry further, in order to improve profitability. Under this plan, industry experts predict that 92 small and unprofitable manufacturers will be closed, allowing the redistribution of 3.757 million cases of quota to larger manufacturers.

STMA is continuing to crackdown on counterfeit and out-of-quota cigarette production, albeit with mixed results. Elimination of illegal production is a high priority, as it undermines the profitability of legal cigarette producers while evading taxes. (Tobacco taxes are one of the government's largest sources of revenue). During 2000, STMA organized 7 major actions against illegal cigarette production and distribution in Henan, Guangdong, Fujian and Guizhou provinces. The cost of the crackdown to the government was about \$40 million. They resulted in the destruction of 3,674 illegal factories and 2,488 cigarette production machines, and the arrest of 3,117 individuals. Total cigarettes seized amounted to 22.8 billion pieces. Despite these efforts, the government is still a long way away from resolving the problem. High prices and taxes make counterfeiting extremely profitable, and non-standard distribution systems make counterfeits extremely difficult to trace, particularly in rural areas.

One of STMA's other major efforts has been to reduce the tar content in cigarettes. In 1989 STMA stipulated that, by the end of 2000, the average tar content of high-quality cigarettes should not exceed 12 mg. Though final statistics are still unavailable, it appears that the industry will come close to that goal. Between 1989 and 1999, average tar per cigarette was reduced from 21.53 mg to 16.62 mg. Recent test results indicate that, of 383 different brands, 2.35% registered a tar content of less than 9 mg, 24.02% between 12-15 mg., 20.1% between 15-16 mg., 22.45% between 16-17 mg., 25.07% between 17-19 mg., 4.7% between 19-20 mg., and 1.31% over 20 mg.

### **Consumption**

High levels of smuggling and illegal cigarette production, as well as production of tobacco for personal use, make it extremely difficult to estimate actual consumption. Per capita consumption appears to be on the decline. Household survey data from the NSB indicate that consumption for urban households fell from 27.25



packs to 26.81 packs, a fall of 1.6%. In rural areas, consumption also declined, falling from 23.64 packs to 23.09 packs. A key reason for the decline is a growing health-consciousness among consumers. The traditional tolerance for smoking in public places also appears to be on the decline. Though such restrictions are routinely ignored, smoking is being banned in a growing number of venues. A final contributing factor to falling tobacco consumption is the decline in the tradition of giving cigarettes as gifts.

Growing incomes and health concerns are leading consumers to demand higher quality cigarettes. Between 1998 and 2000, Class A cigarettes have gone from 14.1% of sales to 18.9%. Class B sales have also increased their share from 13.7% to 21%, while Class C sales have dropped from 43.3% to 32.2% and Class D and E cigarette sales have dropped from 28.9% to 27.9% of total sales. Cigarettes manufactured solely from flue-cured tobacco continue to dominate the market, but are slowly losing ground to low-tar blended cigarettes. Consumption of blended cigarettes is concentrated in the major urban areas, and is still limited to about 5% of total production. The number of companies manufacturing blended cigarettes is limited. British American Tobacco (BAT) is already jointly manufacturing blended cigarettes in China, and plans to begin manufacturing one of its more popular brands (Hilton) in China through a joint venture with Jinan Tobacco. Beijing Cigarette Company has received the support of STMA in developing its own low-tar blended cigarette, Zhongnanhai, which is being exported to Japan as well as sold domestically. Success in the Japanese market has led the company to apply for a larger production quota, as production is currently restricted to 40,000 cases (50,000 pieces per case) per year. A recent change in the cigarette tax has been proposed, which will have the effect of raising the cost of high-quality and imported cigarettes.

## Stocks

In 1988, as part of its macro policy, the government set out to reduce tobacco stocks. Since that time, stocks have been cut by roughly 400 TMT per year, bringing 2000 ending stocks down to an estimated 2.9 MMT. Imbalances in production and demand continue to be a problem, however, as production of low quality tobacco exceeds industry demand, while high quality tobacco production is insufficient. As a result, stocks consist primarily of low-quality tobacco. Cigarette stocks went from 3.44 million cases to 3.89 million cases in 2000, an increase of 13.3%. These surplus stocks have begun to eat into both industry profits and government tax revenue. Overstock of cigarettes is most severe in Yunnan, Liaoning, Shaanxi and Chongqing. Stocks are comprised of mid-to lower grade cigarettes, as follows: Class A, 11.9%; Class B, 20.2%; Class C, 30.1%; Class D, 26.9%; and Class E, 1.9%.

## Trade

### Tobacco

Total imports of leaf tobacco in 2000 amounted to 37,800 MT, a substantial increase over the 10,100 MT imported in 1999. Flue-cured tobacco dominated imports, accounting for 97.1% of the total. Though Chinese processors seek to import higher quality tobacco, they remain extremely price sensitive, and import primarily from Zimbabwe and Brazil for that reason. Total leaf exports amounted to 114,381 MT in 2000, an increase of 3.6% over the previous year, though the total value of exports actually fell to \$175.5 million, \$25.6 million less than the previous year. Flue cured tobacco comprised about 98.4% of exports. Exports increased in 1999 after China increased the VAT rebate on exports, and are forecast to continue growing slowly due to improved cooperation between processors and wholesalers. China exports tobacco primarily to Southeast Asia and Russia, though some 2,900 MT of exports to the United States were also registered in 2000, at a value of \$4.89

million. The general trade pattern involves the export of low-quality tobacco and import of high-quality tobacco, offsetting the imbalance in domestic production.

Although most sources expect imports to increase once China joins the WTO, these imports are likely to be limited by the strict production quotas enforced on cigarette manufacturers. Over the long term, increased production of blended cigarettes should boost demand for imports of burley and oriental tobacco. STMA is attempting to increase domestic production of these types of tobacco, but it remains to be seen whether domestically produced burley and oriental tobacco will be available in sufficient quantities and quality to meet growing demand.

China recently lifted its 11 year ban on imports of U.S. leaf tobacco, which was imposed due to concerns about tobacco blue mold. Initial imports are likely to be limited, however, as U.S. tobacco prices remain substantially higher than those for tobacco from Zimbabwe and Brazil. In addition, those companies interested in using U.S. tobacco to produce blended cigarettes have noted that they will need time to develop their blends. At least one major Chinese manufacturer has already expressed its interest in importing U.S. flue-cured tobacco. Post's forecast for 2001 imports of U.S. tobacco anticipates mostly trial shipments. U.S. companies planning to export tobacco to China should also be aware of the extremely complex import licensing procedures for tobacco imports. These procedures are outlined in report CH1014.

### **Cigarettes**

According to Customs data, total cigarette exports for 2000 amounted to 12.8 billion pieces, an increase of 72% over 1999. China's largest export markets are in Hong Kong and Malaysia, which combined accounted for over 63% of the \$198 million in exports. Total imports amounted to 2.09 billion pieces in 2000, a 15.4% increase from 1999. Imports from the U.S., however, fell by 10.7%, down to 370 million pieces at a value of \$6.7 million.

According to official data, consumption of imported relative to domestic cigarettes actually declined during the 90s. Industry sources attribute this to several factors. First, the quality of domestic cigarettes improved steadily since the early 90s. A side-effect of this is that domestically produced counterfeit cigarettes have also improved in quality, displacing a certain amount of imports. Second, though blends are slowly growing in popularity, domestic smokers continued to prefer the traditional, unblended cigarettes. Third, the price difference between domestic and imported cigarettes is still significant despite tariff reductions: popular brands of imports typically sell for 4 RMB (50 cents) more per pack than the same class of domestic brand cigarettes. Finally, at the high end of the market, there are a growing number of domestic 'luxury' brands which, though substantially more expensive, are preferred as gifts or for 'status' consumption. These brands include various over-the-top touches such as gold leaf and fancy paper, which are not matched by typical imports.

Over the long term, cigarette imports are likely to rise. China's entry into the WTO will provide increased access to foreign cigarettes, and will be supported by growing interest in low-tar and blended cigarettes. Entry into the WTO, by reducing the barriers to legal imports, will also permit some of the current illegal trade to move into legal channels. This will likely show up in official statistics as an increase in trade.

### **Smuggling**

Both official import statistics and Post's PS&D tables, do not include cigarette smuggling, as the amount

smuggled is impossible to determine with any precision. Comparison of Hong Kong re-export data with China Customs data, however, can at least provide some clue to the scale of the problem. Hong Kong re-export statistics show actual exports from Hong Kong (the main source of smuggled goods) to China, while China Customs statistics show legal imports into China. For 2000, Hong Kong registered re-exports of cigarettes to China worth a total of \$159 million. China Customs, however, only registered cigarette imports worth \$39.3 million. A substantial part of this discrepancy is likely the result of deliberate underinvoicing to reduce the amount of duty/tax paid on the imports. Nonetheless, these data indicate that illegal imports are probably equal to or greater than legal imports. The same situation may apply in reverse to exports, with traders declaring a cargo for export in order to collect the VAT rebate, then diverting it back into domestic markets.

According to industry sources, the government's crackdown on smuggling has had a significant impact. Hong Kong re-export data show cigarette exports to China falling from nearly \$255 million in 1998 to \$134 million in 1999. Re-exports rose again to \$159 million in 2000, however, while official imports remained relatively steady, indicating that the effects of the crackdown may be wearing off. China Customs reports that, for the first quarter of 2001, interceptions of smuggled cigarettes amounted to 32,900 cases, a significant increase over the same period last year. The crackdown has focused primarily on large-scale operations connected with high-ranking government officials. While this approach has allowed significant progress at minimum expense, low-level smuggling remains widespread. In addition, some industry sources believe that the absence of smuggled product is merely creating new opportunities for domestic counterfeiters of foreign brands.

### **Tariffs and Non-Tariff Barriers**

China has agreed to cut its tariffs on both leaf tobacco and manufactured tobacco when it joins the WTO. The current MFN tariff rate on tobacco leaf is 40%, with a 17% VAT. This rate is restrictive, and penalizes high-value tobacco products more heavily than cheaper imports. MFN tariff rates for manufactured tobacco remain at 65% for MFN nations, again with a VAT of 17%. This will change when China accedes to the WTO. Under the agreement negotiated with the United States, China will gradually reduce tariffs on tobacco from the current 40% rate down to 10% by 2004. Tariffs on cigarettes will also be reduced, falling from 65% down to 25% by 2004. The current high tariff rates are a major contributor to the smuggling problem.

### **Marketing**

Marketing and distribution of cigarettes remains problematic. Although STMA maintains a monopoly on distribution, this monopoly breaks down at the retail level. Anecdotal evidence indicates that STMA's tobacco monopoly stores account for a mere fraction of retail sales. This confusion at the retail level has made it extremely difficult for STMA to track and prevent the sales of counterfeits.

Although the government has restricted direct advertising for cigarettes, many large cigarette companies have found indirect means for advertising their products. A common tactic is to advertise the corporate group rather than the cigarette brand. Since the group may include non-cigarette companies, this is perfectly legal. One manufacturer, Dahongying, has even managed to advertise its Phoenix brand on CCTV.

### **Taxes**

Several newspapers have recently reported that the government will adjust the tax on cigarettes. (Note: this tax is separate from the VAT). Under this scheme, the tax will be charged on both the quantity and the unit price.

For example, the fixed base tax on one case of cigarettes is \$18.14. In addition to this, additional tax will be charged against the value of the cigarettes. For cigarettes priced at less than \$6.05/carton (200 pieces), the tax will be 30%. For cigarettes priced at \$6.05/carton or higher, the tax will be 45%. This change will raise the relative price of the higher classes of cigarettes, including most imports.